



PUBLIC ACCOUNTS COMMITTEE

Inquiry into the Collapse of the New South Wales Grains Board



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NSW Grains Board

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Charter of the Committee

The Public Accounts Committee has responsibilities under the *Public Finance and Audit Act 1983* to inquire into and report on activities of government that are reported in the State's Public Accounts and the accounts of the State's authorities.¹ The Committee, which was established in 1902, scrutinises the actions of the Executive Branch of Government on behalf of the Legislative Assembly.

The Committee recommends improvements to the efficiency and effectiveness of government activities. The sources of inquiries are the Auditor-General's reports to Parliament, referrals from Ministers and references initiated by the Committee. Evidence is primarily gathered through public hearings and submissions. As the Committee is an extension of the Legislative Assembly its proceedings and reports are subject to Parliamentary privilege.

Members of the Committee

The Committee comprises members of the Legislative Assembly and assumes a bi-partisan approach in carrying out its duties.

Chairman:	Joseph Tripodi MP, Member for Fairfield
Vice-Chairman:	The Hon. Pam Allan MP, Member for Wentworthville
Members:	Ian Glachan MP, Member for Albury
	Katrina Hodgkinson MP, Member for Burrinjuck
	Richard Torbay MP, Member for Northern Tablelands
	Barry Collier MP, Member for Miranda

Committee Secretariat

Secretariat members involved in the Inquiry were:

Acting Committee Manager:	David Monk
Committee Manager:	Yael Larkin (to 13 February 2001)
Committee Officer:	Stephanie Hesford
Assistant Committee Officer:	Mohini Mehta
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¹ See Part 4 of the Act – The Public Accounts Committee.



Chairman's Foreword

The collapse of the Grains Board combined many aspects of past failures in the public and private sectors. There were precedents in the failures of the marketing boards it replaced, the upheavals at Integral Energy with its significant losses and with the corporate failures of the eighties. The comprehensiveness of the Grains Board's collapse reflects poorly on those, both internal and external, who failed to exercise their responsibilities.

The main reason for the collapse of the Grains Board was its unusual nature. Ownership and control were poorly linked and defined, leaving it in a corporate quandary with stakeholder's interests unaligned with those of the organisation.

Like many government agencies in competitive markets the Grains Board faced pressures from national competition policy and rationalisation in its industry.

Under the *Grain Marketing Act 1991*, the Grains Board was obliged to pursue conflicting objectives: the satisfaction of grain growers and its own financial welfare. After years of steady growth the Grains Board became more aggressive in the market place. It achieved its growth by engaging in higher risk activities, including paying high prices for product, aimed at achieving market dominance and popularity.

The Grains Board experienced the following corporate governance failures:

- The board and consultative committee were constituted by nominees from the NSW Farmers Association who were using the Grains Board to maintain industry dominance.
- The Managing Director dominated the outgoing board and continued the growth strategy for many months under the new board before its failures were obvious.
- The boards, particularly 1995 to 1999, failed to direct and control management.
- The Chairmen failed to lead the boards.

Compounding these corporate governance problems were weaknesses with systems and procedures. Practices that had matured over seven years of gradual growth failed to cope with rapid expansion. Poor quality information going to the board indicts both the Managing Director and the Chief Finance Officer.

Further, external accountability requirements failed, implicating the Director-General of the Department of Agriculture, Auditor-General, Treasury and the NSW Farmer's Association. Ineffective oversight and reporting resulted in Ministers and the Parliament being poorly informed. In addition, the Grains Board's bankers continued to provide finance based on poor commercial judgement. Fortunately, the *Grain Marketing Act 1991* protects the State from the liabilities of the Grains Board.



Matters of possible corrupt or criminal conduct are subject to investigation by the Independent Commission Against Corruption. It is also likely the administrator of the Grains Board will reveal more as his investigations and wind-up continue.

Since the Grains Board no longer actively trades, the report's recommendations are targeted at improvements to corporate governance and accountability at the broader level. The Committee will consider the need for any further inquiry based on the responses to the recommendations and the results of the Audit Office's current performance audit into risk management.

The Committee wishes to thank all parties who made submissions to the Inquiry and all public officials who provided information and gave evidence.

Joe Tripodi

Joseph Tripodi MP
Chairman



Executive Summary

Background

The NSW Grains Board was established in 1991. At 31 August 1999 its audited accounts reported reserves of \$24.6 million, built on an increasing turnover. The Grains Board's administrator estimated losses in excess of \$90 million and a balance sheet deficit of at least \$60 million at 31 August 2000.

The Grains Board's activities were based on the monopoly (vested) powers for the exporting of grains (including barley, sorghum, oats) and oil seeds (including canola, sunflower, safflower). The Grains Board could also market non-vested grains and oilseeds domestically, and undertake ancillary activities such as processing, transport and storage.

The administrator was appointed by the Minister of Agriculture in November 2000 to take over the functions of the Grains Board. In the same month, the operations of the Grains Board were sold to Queensland based Grainco Australia Ltd for \$25.3m.

The full extent of the Grains Board's losses will not be known until the administrator realises the remaining assets and liabilities. The Grains Board's bankers will bear the greater part of the losses.

Please note that in this report, "board" refers to the seven members of the Grains Board who operate in a similar manner to a company's board of directors. "Grains Board" is used to refer to the operating entity.

The Inquiry

The aims of the Committee's inquiry were to examine how the Grains Board incurred the financial losses, why it happened, and who might be accountable. Five public hearings were held in November 2000.

While the *Grains Marketing Act 1991* limits the exposure of the Government to the Grains Board's financial losses, its collapse has resulted in the loss of equity that was accumulated since its inception with the support of NSW grain growers. It was apparent to the Committee the outcome reflected poorly on a number of stakeholders with responsibilities for the Grains Board.

The Committee undertook an inquiry in its role as Parliament's watchdog over financial accountability across government.

As the inquiry unfolded, the greatest challenge for the Committee was dealing with the failure of so many safeguards and the deflection of responsibility for breakdowns by so many stakeholders.



The report is centred on chapters two to five, which represent the four main themes of the inquiry. Where appropriate, Grains Board practices have been contrasted with best practice. The report draws heavily on extracts from the transcripts of hearings to substantiate its findings and conclusions. As the Grains Board is no longer an operating entity, the report's recommendations focus on improvements to accountability elsewhere in NSW.

Conclusions

The Committee believes responsibility for the failure of the Grains Board is shared by the key stakeholders. These include board members, executive management, the Director-General Department of Agriculture, the NSW Farmers' Association, the Auditor-General and the Grains Board's bankers.

The Committee has concluded responsibility is shared by those who:

- established the Grains Board with conflicting objectives and interests – *government*
- pursued alternative agendas over sound business practices by failing to take a balanced approach to the Grains Board's objectives – *the board and executive management*
- failed to undertake an independent assessment and failed in their reporting on the Grains Board – *the Director-General, Auditor-General, bankers, and Treasury*
- maintained information systems and risk management practices that produced inaccurate, incomplete and untimely reporting resulting in key decision makers being ill-informed – *the board and executive management.*

These weaknesses, combined with the growth in grain volumes in late 1999, triggered the Grains Board's collapse.

The Committee is of the view primary responsibility for the failure of strategy and internal controls must ultimately rest with the board of the Grains Board that ceased on 30 June 1999. This board had established and consolidated the Grains Board's direction and controls. Senior executives, such as the Managing Director and the Chief Finance Officer, must take considerable responsibility for the poor state of the management systems and reporting.

The Committee's conclusions are supported by the following findings.

Finding: Corporate objectives and the governance framework were defective (pages 12-15 and 18-22)

The Grain Marketing Act established two conflicting objectives for the Grains Board, namely to:

- represent the demands of growers, and
- maintain profitable activities.



In its later years, the Grains Board's growth strategy required generous prices being paid to growers to achieve the volume. This placed the Grains Board's financial performance at risk. The growth strategy was motivated and directed at fighting market deregulation proposed by the national competition review.

The board did not recognise the weaknesses in its legislation and insufficient direction was provided by the board, and, in turn, executive management. It appeared to the Committee that the Managing Director masterminded and wholeheartedly drove the growth strategy and the board was not aware of the full implications.

Finding: The board suffered from restricted membership (pages 15-18)

Growers nominated by the NSW Farmers' Association had an absolute majority on the board and Consultative Committee.

The Committee is of the view this dominance contributed to the Grains Board's financial problems by restricting the range of growers' and market views put to the board. There was a significant proportion of growers who did not support the regulation of markets who were not represented. The NSW Farmers Association support of the vesting rights arrangements through the Grains Board was partly motivated to ensure the Association's dominance of the industry.

Recommendation 1

The NSW Government should review all legislation that creates organisations with commercial activities whose objectives have potential conflicts and create significant business risks. This review should be followed up by legislation to ensure each of these boards have:

- a majority of independent board members with commercial backgrounds; and
- an active consultative committee representing a cross section of stakeholder interests, including industry (both representatives from institutions and individually) and government.

Finding: Board members relied on internal procedures without due oversight (pages 23-31)

The Committee found the board regularly over-relied on executive management, internal control systems and the external auditor's reports. For example, the board created trading policies but failed to understand the full implications of non-compliance with these policies. The board also failed to detect non-compliance with the Grains Board's policies, and once these were detected by the Audit Office, failed to initiate corrective measures.



The Committee accepts the board were not necessarily experts and needed to rely on the advice and direction of management. However, this does not imply they should passively accept information and recommendations put to them. For too long, the board accepted voluminous and poorly presented reports from management. Practices such as these meant management were not questioned by the board.

Finding: The Audit Committee abdicated its responsibilities to management (pages 33-36)

Similarly, the board's Audit Committee appears to have accepted management views and management's aggressive/defensive approach towards the auditors. In this respect, the audit committee failed to create an atmosphere of openness and accessibility for audit feedback and discussion.

Finding: The Consultative Committee did not fulfil its obligations (pages 31-33)

A duty of the Consultative Committee was to represent grower interests by critically scrutinising the operations of the Grains Board. However, it was unaware of the impact of high purchase prices on the Grains Board's financial stability.

The Committee found the Consultative Committee failed to pursue its role adequately. The Consultative Committee should have been in a position to critically assess the Grains Board's growth strategy and its implications. It should have made recommendations to the board in this regard.

Finding: The Managing Director sought to avoid responsibility (see pages 36-41)

The Managing Director is responsible for the day to day running of an organisation, which complements the board's role in providing strategic direction and oversight.

The Managing Director admitted to varying levels of responsibility. To some extent this is representative of the Managing Director's pivotal position in the organisation. However, the Committee believes the extent of evasion and conflict in the Managing Director's evidence indicates he failed to properly perform his duties and responsibilities. The Managing Director sought to deflect responsibility for problems with accounting systems and reporting to the board and the auditors. Further, the Managing Director's ability to exercise his independent judgement and fulfil his duties appears to have been compromised by his close relationship with the Chief Financial Officer.

Finding: The Director General of the Department failed his statutory responsibilities (pages 41-44)

The *Grain Marketing Act 1991* provided the Director-General of the Department of Agriculture with powers to independently assess the activities of the Grains Board. The responsibilities include assessing reports from the Grains Board, providing advice to the Minister, and conducting management audits. To assist with these



tasks, a representative of the Department was on the Grains Board's Consultative Committee.

The Committee finds the Director-General did not carry out his duties effectively. For example, the Grains Board achieved an operating profit at 31 August 1999 of \$2.45 million by imposing an administrative charge on the pool accounts of \$2.7 million. The size of this charge, which took the Grains Board's financial position from the red into the black, should have been investigated. The inaction was consistent with the Director General's perceived passive role.

Finding: No monitoring by NSW Treasury of the Grains Board's performance (pages 44-45)

Treasury advised the Committee they had no active interest in the Grains Board as it did not represent the Crown and had no direct relationship with the State's finances.

However, the Committee believes Treasury should have scrutinised the Grains Board's operations, considering Treasury's objectives to improve public accountability and the prominence of the Grains Board in one of the State's major industries.

Recommendation 2

Treasury should examine the possible exposures to the State's finances from the operations of statutory authorities not under regular review. Treasury to provide ongoing monitoring of the higher-risk statutory authorities.

Finding: The Grains Board's banks appeared to conduct limited due diligence reviews (pages 45-48)

The Commonwealth Bank appeared to place undue reliance on the fact the Grains Board was a statutory authority, even though this clearly meant no government guarantee was involved. The banks relied on unqualified audit opinions from the Auditor-General without undertaking a sufficient degree of its own monitoring. The growth in funding by the banks appeared to occur without reference to the Grains Board's thin capital base. At one stage, the Grains Board had a lower capitalisation than required by banks.

Finding: Internal auditing was not well directed by the audit committee (pages 48-51)

Internal audit coverage was at a minimum and this is attributable to the incompetence of the Audit Committee. The Audit Committee did not seek to use the internal auditors as an effective review of management controls. Further, the Audit Committee and the board were not active in resolving internal audit recommendations in a competent manner.



Finding: The Public Accounts Committee cannot properly advise the Parliament without access to Audit Office documents (pages 52-54)

During evidence, the Auditor-General advised he had a legal opinion from the Crown Solicitor that the secrecy provisions in the *Public Finance and Audit Act 1983* precluded him from providing Audit Office documents to the Committee. Although in this case the Committee obtained the documents from alternative sources, the Committee is of the view this matter requires further attention.

Recommendation 3

The Committee is of the view that the matter of the Committee's powers should be clarified in the *Public Finance and Audit Act 1983* by expressly restating the Committee's existing powers, as has occurred with later Acts pertaining to parliamentary committees, such as, section 31G of the *Ombudsman Act 1974*, section 69 of the *Independent Commission Against Corruption Act 1988*, and schedule 1(5) of the *Commission for Children and Young People Act 1998*. In particular:

- the *Public Finance and Audit Act 1983* expressly reiterate that "The Committee has power to send for persons, papers and records";
- the *public finance and Audit Act 1983* be amended to enable the Committee to call for papers and records; and
- the *Public Finance and Audit Act 1983* be amended to enable the Committee to access documentation from the Auditor-General.

Finding: The Audit Office did not consider its audience in preparing the Auditor-General's reports to Parliament (pages 59-60)

Although an accountant would be aware of concepts raised in these reports, the readers of the reports are the general public and Members of Parliament. The majority of these people would need to have the reports explained.

Recommendation 4

The Audit Office should take its wider audience into account in preparing the Auditor-General's reports to Parliament. These reports should explain why listed issues are significant and their financial implications.

Finding: The Auditor-General did not report repeat audit findings effectively (pages 62-64)

As well as an opinion on an agency's annual financial statements, the Auditor-General provides reports to the agency's board (or equivalent), Minister, Treasurer



and Parliament. These reports provide levels of detail in decreasing order in respect of audit findings on accounting, control and compliance issues. The Committee focused its attention on the content of these reports.

The Committee found the reporting to Parliament and to the Ministers was inadequate. The Government did not have the information that would have initiated its remedial involvement. Matters relating to the escalating operational risks were only mentioned in three detailed letters to management. However, the recurrence of the findings and the implications of inaction by the board and management were not featured in the reports to the Ministers and Parliament. The Committee believes it is reasonable to expect the Auditor-General should have reported on these matters in more detail.

Recommendation 5

The Audit Office and Auditor-General include significant repeat and unresolved findings in their statutory audit reports and reports to Parliament and label them accordingly.

Finding: The Auditor General's focus and reporting on business risk was restricted (pages 64-66)

A recent emphasis of the Audit Office's approach to financial audits has been on understanding the client's business, the client's risks and how they control these risks. Risk was an important issue for the Grains Board as it had a small capital base relative to its borrowings. Further, its turnover was increasing.

The Committee found the Auditor-General's reports to the Ministers and Parliament did not adequately connect growth and risk.

Recommendation 6

The Auditor-General's statutory reports and reports to Parliament must explicitly report significant changes in a client's risk profile from the previous year. The reports should include critical findings.

In relation to improving risk management coverage, past reviews of the Audit Office conducted by the Committee have recommended:

- the mandate of the Auditor General should be extended to include an expression of an opinion on the risk management disclosures to be included in agencies' annual reports; and
- the Audit Office should attempt to integrate the skills and expertise of performance auditors with those of financial auditors.

The Committee recognises the merit in these initiatives.

**Recommendation 7**

The Auditor-General's current performance audit into risk management practices across government examine how the monitoring and expression of an opinion on the risk management disclosures included in annual reports of government departments and agencies might be implemented.

Finding: Neither the board nor management were in control of the growth in trading volumes (pages 71-84)

Evidence presented to the Committee indicated the Grains Board was, in late 1999, trading in volumes significantly in excess of its budget. The poor information systems meant the board was unaware it was over budget. The expansion dramatically increased financial and operational risks. At this time, there was no moderating influence on the organisation, from outside or within.

Finding: The Grains Board operated with inadequate and inappropriate systems and procedures (pages 85-110)

The Committee found the accounting and stock control systems had a history of inadequacy. This included:

- stock records being inaccurate, incomplete and supporting poor control practices;
- trade debtors not being reconciled and trading in excess of limits; and
- accounting treatments that distorted the financial position.

The poor quality of information from these systems limited the effectiveness of the board.

The Committee found that until March 2000 the Grains Board lacked an effective risk committee to monitor trading operations. The Committee heard evidence that the compartmentalised structure within the Grains Board and the poorly integrated management systems contributed to the lack of co-ordination and control of trading operations.

The lack of compliance with procedures and the inadequacy of systems was raised on a number of occasions with management and the board. Action was rarely taken, and if it was, it was usually insufficient.